INDIA

The Department of State submitted this report to the Senate Committees on Foreign Relations and on Finance and to the House Committees on Foreign Affairs and on Ways and Means, on January 31, 1999.

Key Economic Indicators

(Billions of U.S. Dollars unless otherwise indicated)

	1996	1997	1998 1/
Income, Production and Employment:			
Nominal GDP 2/	315.0	332.0	378.0
Real GDP Growth (pct) 3/	7.5	5.1	5.5-6
GDP by Sector (pct estimated):			
Agriculture	27.1	27.5	N/A
Manufacturing	30.6	30.5	N/A
Services	42.3	42.0	N/A
Government	N/A	N/A	N/A
Per Capita GDP (US$)	379.0	396.0	398.0
Labor Force (millions)	378.0	397.0	410.0
Unemployment Rate (pct)	22.5	22.5	22.5
Money and Prices (annual percentage growth):			
Money Supply Growth (M2)	16.2	17.6	21.0
Consumer Price Inflation	10.0	8.3	12.5
Exchange Rate (Rupee/US$ annual average)			
Official	35.46	37.11	41.30
Parallel	35.50	37.16	41.36
Balance of Payments and Trade:			
Total Exports FOB 4/	33.5	34.0	35.0
Exports to U.S. 5/	6.6	6.7	7.0
Total Imports CIF 4/	39.1	40.8	43.5
Imports from U.S. 5/	3.4	3.5	3.8
Trade Balance 4/	-5.6	-6.8	-8.5
Balance with U.S. 5/	3.2	3.2	3.2
Current Account Deficit/GDP (pct)	1.0	1.7	2.0
External Public Debt 6/	90.8	94.4	95.0
Debt Service Payments/GDP (pct)	4.0	4.3	3.9

Fiscal Deficit/GDP (pct)	5.3	6.2	5.6
Gold and Foreign Exchange Reserves	26.4	29.5	30.0
Aid from U.S. (US$ million)	136.3	142.3	141.0
Aid from Other Countries	2.5	3.2	N/A

1/ Data are for Indian fiscal year (April 1 to March 31) unless otherwise noted. 1998-99 figures are all embassy estimates based on data available in October 1998.

2/ GDP at factor cost.

3/ Percentage changes calculated in local currency.

4/ Merchandise trade.

5/ Source: U.S. Department of Commerce and U.S. Census Bureau; calendar year, exports FAS, imports customs basis; 1998-99 figures are estimates based on data available through October 1998.

6/ Includes rupee debt of $10 billion to the former USSR.

Sources: Indian Government economic survey, Indian Government budgets, Reserve Bank of India bulletins, World Bank, USAID, and private research agencies.

1. General Policy Framework

Economic reforms since 1991 have helped India achieve a large measure of macroeconomic stability and a moderate degree of liberalization of its trade, investment and financial sectors. The U.S. continues to be the largest investor in India and its biggest trading partner. With the formation of a new coalition government in March 1998 led by the Bharatiya Janata Party (BJP), all major parties have declared their support for the overall necessity of continued reform. Significant differences remain however, on the pace and emphasis of reform.

The Indian economy has the potential to perform well, and the long-term prospects remain encouraging. There are continuing concerns, though, about inadequate infrastructure and chronic large budget deficits. Growth has slowed during the past year due to falling demand, high real interest rates, political uncertainty and secondary effects from the economic crisis in other parts of Asia. GDP growth slowed to 5 percent in Indian Fiscal Year (IFY) 1997-98, compared to a growth of about 7 percent recorded in each of the preceding three years. For IFY 1998-99, embassy projects GDP growth of about 5.5 to 6 percent and industrial growth of about 4.5 percent. The central government deficit has hovered around 5 to 6 percent of GDP with the consolidated public sector deficit (including states) remaining at a relatively high level of 9 percent of GDP.

During the first six months of FY 1998-99, money supply (M3) rose by an estimated 20.6 percent. The Reserve Bank of India (RBI) hopes to peg M3 growth at 15 to 15.5 percent for the year. Credit policies for 1998-99 announced in April and October 1998 have been aimed at accelerating industrial investment and output, and reducing interest rates while improving credit availability to business. Government and private forecasters now predict an average inflation rate (as measured by the Consumer Price Index) of between 12 to 13 percent during FY 1998-99, following inflation of 8.3 percent in the previous year.

2. Exchange Rate Policy

India has used exchange rate policy to improve its export competitiveness. On March 1, 1993, the exchange rate was unified and the rupee was made fully convertible on the trade account. On August 20, 1994, the rupee was made fully convertible on the current account. Controls remain on capital account transactions, with the exception of Non-Resident Indians (NRIs) and Foreign Institutional Investors (FIIs), but their gradual removal is expected as foreign exchange reserves grow and India makes progress in merging its capital markets with international financial markets. In June 1997, the Tarapore Committee on Capital Account Convertibility recommended a three year (1998-2000) period for complete capital account convertibility of the rupee. The government recently stated however, that India is in no hurry to complete full convertibility, especially given the ongoing crisis in East Asian economies and the need to further strengthen the banking sector.

The RBI intervenes in the foreign exchange market to maintain a stable rupee. The rupee is tied to a basket of currencies with the U.S. Dollar playing a predominant role. In IFY 1997-98, the exchange rate moved in the range of rupees 35.45-39.49 per dollar. From April to September 1998, the rupee depreciated by 13.1 percent and is currently trading in the range of 42.25-42.38 per dollar. India has been shielded from the East Asian currency crisis due to a staged approach to liberalization and its relatively low degree of exposure to global markets. India’s short term foreign borrowing is low and Indian banks and financial institutions have very little exposure to the real estate sector.

3. Structural Policies

Pricing Policies: Central and state governments still regulate the prices of most essential products, including food-grains, sugar, edible oils, basic medicines, energy, fertilizers, water, and many industrial inputs. Agricultural commodity procurement prices have risen substantially during the past seven years, while prices for nitrogenous fertilizer, rural electricity and irrigation are subsidized. Acute power shortages are forcing several states to arrest the financial decline of state electricity boards by moving to market pricing. The federal government has also begun to scrutinize more carefully the cost of its subsidies. The government in 1997 announced a plan to reduce subsidy rates on food, and fertilizers from the existing 90 percent to 25 percent over the next five years. In September 1997, the government increased the prices of several petroleum products and committed to dismantling the Administered Price Mechanism for petroleum products over the next two years. However, progress has been slow.

Many basic food products are under a dual pricing system: some output is supplied at fixed prices through government distribution outlets ("fair price shops"), with the remainder sold by producers on the free market. Prices in government outlets are usually regulated according to a cost-plus formula; some formulas have not been adjusted in more than a decade. Regulation of basic drug prices has been a particular problem for U.S. pharmaceutical firms operating in India, although changes in national drug policy have sharply reduced the number of price-controlled formulations from 142 in 1994 to 72 at present.

Tax Policies: Public finances remain highly dependent on indirect taxes, particularly import tariffs. Between 1990 and 1997, indirect taxes accounted for about 75 percent of central government tax revenue. India's direct tax base is very narrow, with only 14 million taxpayers out of a total population of about 960 million. Marginal corporate rates are high by international standards, although the FY 1996-97 budget lowered the corporate income tax rate for foreign companies from 55 percent to 48 percent. Tax evasion is widespread, and the government has stated that future rate cuts will depend on the success of efforts to improve tax compliance. Over the last six years, the government has been streamlining the nation's tax regime along the lines recommended by a government-appointed committee: increasing the revenue share from direct taxes, introducing a Value-Added Tax (VAT), and replacing India's complex tax code with one that is simple and transparent. The government also provides tax incentives for specific sectors, such as a 5-year tax holiday for infrastructure projects.

Regulatory Policies: The "new industrial policy" announced in July 1991 considerably relaxed government's regulatory hold on investment and production decisions. Under the new policies, industrial licenses are only required for 6 areas, defined as strategic. Some restrictions also remain for manufacturing in sectors which are reserved for the public sector or small-scale industry. Additionally, the government announced in 1994 and 1995 liberal policies for the pharmaceutical and telecommunications industries. Most plant location strictures have been removed. Nevertheless, Indian industry remains highly regulated by a powerful bureaucracy armed with excessive rules and broad discretion. Government approval of foreign business investment projects often takes three to five years. As economic reforms take root at the federal level, the focus of liberalization is gradually shifting to state governments, which, under India's federal system of government, enjoy broad regulatory powers. The speed and quality of regulatory decisions governing important issues such as zoning, land-use and environment can vary dramatically from one state to another. Political opposition has slowed or halted important regulatory reforms governing areas like labor, bankruptcy, and company law that would enhance the efficiency of domestic and foreign investment.

4. Debt Management Policies

External Debt Management: India's reliance during the 1980's on debt-financed deficit spending to boost economic growth meant that commercial debt and Non-Resident Indian (NRI) deposits provided a growing share of the financing for India's mounting trade deficit. The result was a hefty increase in external debt, compounded by rising real interest rates and a declining term structure that reflected India's falling creditworthiness. Total external debt rose from $20 billion in FY 1980-81 to about $84 billion in FY 1990-91. Fueled by rising debt service payments, foreign exchange reserves fell to $1.1 billion (excluding gold and SDRs) during the FY 1990-91 balance of payments crisis, the equivalent of only two weeks of imports. By October 1998, India's reform program had succeeded in boosting reserves to $26.7 billion (excluding gold and SDRs).

External Debt Structure: India's total external debt reached $94.4 billion by March 1998. Debt service payments were estimated at $14.4 billion in 1997-98. Roughly two-thirds of the country's foreign currency debt is composed of multilateral and bilateral debt, much of it on highly-concessional terms. The share of concessional debt in total debt is about 43 percent. The addition of new debt has slowed substantially, as the government has maintained a tight rein on foreign commercial borrowing and defense-related debt and has encouraged foreign equity investment rather than debt financing. As a result, the ratio of total external debt to GDP fell from 39.8 percent in FY 1992-93 to 25 percent in FY 1997-98.

Relationship with Creditors: India has an excellent debt servicing record. However, Standard and Poor's (S&P) in October 1998 downgraded India's foreign currency debt from BB+ to BB, one notch below the highest speculative grade. On the other hand, S&P at the same time upgraded its outlook on India from negative to stable. In June 1998 -- after the U.S. imposed economic sanctions on India following nuclear tests -- Moody's lowered India's foreign currency rating by two notches, from investment grade to speculative grade. Citing its growing foreign exchange reserves and ample food stocks, India chose not to negotiate an extended financing facility with the IMF when its standby arrangement expired in May 1993.

5. Significant Barriers to U.S. Exports

Import Licensing: U.S. exports have benefited from significant reductions in India's import-licensing requirements. Since 1992, the government has eliminated the licensing system for imports of intermediates and capital goods, and has steadily reduced the import-weighted tariff from 87 percent to 23 percent at present. U.S. exports to India rose from $2.0 billion in 1991-92 to approximately $3.5 billion in 1997-98, according to Indian Commerce Ministry trade data. The Government of India currently maintains import restrictions on more than 2,700 tariff line items. For this reason, the U.S. Government recently brought a World Trade Organization (WTO) dispute settlement case against the Government of India requesting that these restrictions be removed. In December 1998, the WTO dispute settlement panel issued an interim report agreeing with the U.S. position that these Indian restrictions are a serious impediment to U.S. exports of industrial and agricultural goods, and are clearly WTO-inconsistent and not justifiable by India on balance of payments grounds. If this part of the decision is carried forward to the final report, it will result in a significant market opening for U.S. exports.

Some commodity imports must be channeled ("canalized") through public enterprises, although many "canalized" items are now decontrolled. The main canalized items currently are petroleum products, bulk agricultural products such as grains and vegetable oils, and some pharmaceutical products. U.S. exporters face a negative list of items which cannot be imported, affecting roughly one-fourth of all tariff lines, and tariff protection that is still very high by international standards. Import licenses are still required for pesticides and insecticides, fruits, vegetables and processed consumer food products, breeding stock, most pharmaceuticals and chemicals, and products reserved in India for small-scale industry. This licensing requirement serves in many cases as an effective ban on importation. The new Export-Import Policy effective April 1, 1998, allowed import of several additional consumer products.

Services Barriers: The government runs many major service industries either partially or entirely, but private sector participants are increasingly being allowed to compete in the market. Entry of foreign banks remains highly regulated, but approval has so far been granted for the operation of 25 new foreign banks or bank branches since June 1993, when the RBI issued guidelines under which new private banks may be established. Furthermore, financial authorities have permitted sweeping changes in non-bank financial services since then. India does not allow foreign nationals to practice law in its courts, but some foreign law firms maintain liaison offices in India. The government is now reviewing its monopoly on life and general insurance with a view to future liberalization and reform of the industry. Foreign and domestic joint ventures participate in telecommunications, advertising, accounting, and a wide range of consultancy services. There is a growing awareness of India's potential as a major services exporter and increasing demand for a more open services market.

Standards, Testing, Labeling and Certification: Indian standards generally follow international norms and do not constitute a significant barrier to trade. However, India's food safety laws are often outdated or more stringent than international norms. Where differences exist, India is seeking to harmonize national standards with international norms. No distinctions are made between imported and domestic goods, except in the case of some bulk grains.

Investment Barriers: The industrial policy introduced in July 1991 achieved a dramatic overhaul of regulations restricting foreign investment. The requirement for government approval for equity investments of up to 51 percent in 35 industries covering the bulk of manufacturing activities has been entirely eliminated, although the government reserves the right to deny requests for increased equity stakes. In December 1996, thirteen industries were added to the 35 already eligible for automatic approval of FDI up to 51 percent of equity. In addition, automatic approval up to 74 percent of FDI was introduced for the first time for nine categories including electricity generation and transmission, and construction. However, government approval of foreign infrastructure projects is frequently stalled for lengthy periods of time.

Most sectors of the Indian economy are now open to foreign investors, except those that raise security concerns such as defense, railways and atomic energy. The U.S. and India have not negotiated a Bilateral Investment Treaty, although an agreement covering the operations of the Overseas Private Investment Corporation (OPIC) was updated in 1997. OPIC operations resumed in December 1998, following the partial lifting of sanctions imposed on India after its nuclear tests in May 1998. In 1994, India became a member of the Multilateral Investment Guarantee Agency (MIGA), an agency of the World Bank. The Indian Government ratified the Uruguay Round GATT agreement on January 1, 1995 and is a member of the WTO.

Government Procurement Practices: Indian Government procurement practices are not transparent and occasionally discriminate against foreign suppliers, but they are improving under the influence of fiscal stringency. Price and quality preferences for local suppliers were largely abolished in June 1992. Recipients of preferential treatment are now concentrated in the small-scale industrial and handicrafts sectors, which represent a very small share of total government procurement. Defense procurement through agents is not permitted, forcing U.S. firms to maintain resident representation. When foreign financing is involved, procurement agencies generally comply with multilateral development bank requirements for international tenders.

Customs Procedures: Liberalization of India's trade regime has reduced tariff and non-tariff barriers, but it has not eased some of the worst aspects of customs procedures. Documentation requirements, including ex-factory bills of sale, are extensive and delays frequent. In 1996, the government switched to the harmonized system of commodity classification, removing ambiguities and providing more transparency to its export-import policy.

6. Export Subsidies Policies

The 1991 budget phased out most direct export subsidies, but a tangle of indirect subsidies remains. Export promotion measures include exemptions or concessional tariffs on raw materials and capital inputs, and access to Special Import Licenses (SIL) for restricted inputs. Concessional income tax provisions apply to exports (export earnings are tax-exempt). Commercial banks provide export financing on concessional terms.

7. Protection of U.S. Intellectual Property

India is a signatory of the GATT Uruguay Round and World Trade Organization (WTO) agreements, including the Agreement on Trade-Related Aspects of in Intellectual Property Rights and Services (TRIPS), and is obligated to bring its laws and enforcement efforts into TRIPS compliance by January 1, 2000. The government has announced its intention to take full advantage of the 2005 transition period permitted to developing countries under TRIPS before implementing full patent protection. India is a member of the Berne Convention for the Protection of Literary and Artistic Works, and in August 1998, it became a member of the Paris Convention and the Patent Cooperation Treaty.

In April 1998, the U.S. and India reached an agreement to resolve a long-running dispute over India's failure to implement its WTO TRIPs mailbox requirements for the filing of pharmaceutical and agricultural chemical product patent applications, and failure to implement a system for the granting of exclusive marketing rights. On November 23 1998, government officials introduced a patent bill establishing a "mailbox" system and allowing exclusive marketing rights. If passed, the bill will put India in compliance with its TRIPS obligations.

Over the past decade, USTR has targeted India as a Priority Foreign Country in the “Special 301" process, and despite some improvements, India is still included in the “Special 301" Priority Watch List. Based on past practices, India was identified in April 1991 as a “Priority Foreign Country” under the “Special 301" provision of the 1988 Trade Act, and a Section 301 investigation was initiated on May 26, 1991. In February 1992, following a nine-month Special 301 investigation, the USTR determined that India’s denial of adequate and effective intellectual property protection was unreasonable and burdens or restricts U.S. commerce, especially in the area of patent protection. As a result, in April 1992, the President suspended duty-free privileges under the Generalized System of Preferences (GSP) for $60 million in trade from India. In June 1992, additional GSP benefits were withdrawn, increasing the trade for which GSP is suspended to approximately $80 million.

India's patent protection is weak and has especially adverse effects on U.S. pharmaceutical and chemical firms. Estimated annual losses to the pharmaceutical industry due to piracy are $450 million. India's Patent Act prohibits patents for any invention intended for use or capable of being used as a food, medicine, or drug or relating to substances prepared or produced by chemical processes. Many U.S.-invented drugs are widely reproduced since product patent protection is not available. Processes for making drugs are patentable, but the patent term is limited to the shorter of five years from the grant of patent or seven years from the filing date of the patent application. Product patents in other areas are granted for 14 years from the date of filing.

India continues to have high piracy rates for all types of copyrighted works. Strong criminal penalties are available on paper, and the classification of copyright infringements as "cognizable offenses" theoretically expands police search and seizure authority. However, the severe backlogs in the court system and excessive procedural requirements result in very few cases being brought to conclusion.

Trademark protection is considered good, and will be raised to international standards with the passage of a new Trademark Bill that codifies existing court decisions on the use and protection of foreign trademarks, including service marks. The bill was first introduced in 1995 but failed to win parliamentary approval. Passage of the bill is expected in 1999. Enforcement of trademark owner rights has been indifferent in the past, but is steadily improving as the courts and police respond to domestic concerns about the high cost of piracy to Indian rights' holders.

8. Worker Rights

a. The Right of Association: India's Constitution gives workers the right of association. Workers may form and join trade unions of their choice; work actions are protected by law.

Unions represent roughly 2 percent of the total workforce, and about 25 percent of industrial and service workers in the organized sector.

b. The Right to Organize and Bargain Collectively: Indian law recognizes the right to organize and bargain collectively. Procedural mechanisms exist to adjudicate labor disputes that cannot be resolved through collective bargaining. State and local authorities occasionally use their power to declare strikes "illegal" and force adjudication.

c. Prohibition of Forced or Compulsory Labor: Forced labor is prohibited by the constitution; a 1976 law specifically prohibits the formerly common practice of "bonded labor." Despite implementation of the 1976 law, bonded labor continues in many rural areas. Efforts to eradicate the practice are complicated by extreme poverty and jurisdictional disputes between the central and state governments; legislation is a central government function, while enforcement is the responsibility of the states.

d. Minimum Age for Employment of Children: Poor social and economic conditions and lack of compulsory education make child labor a major problem in India. The government's 1991 census estimated that 11.3 million Indian children from ages 5 to 15 are working. Non-governmental organizations estimate that there may be more than 55 million child laborers. A 1986 law bans employment of children under age 14 in hazardous occupations and strictly regulates child employment in other fields. Nevertheless, hundreds of thousands of children are employed in the glass, pottery, carpet and fireworks industries, among others. Resource constraints and the sheer magnitude of the problem limit ability to enforce child-labor legislation.

e. Acceptable Conditions of Work: India has a maximum eight-hour workday and 48-hour workweek. This maximum is generally, observed by employers in the formal sector. Occupational safety and health measures vary widely from state to state and among industries, as does the minimum wage.

f. Rights in Sectors with U.S. Investment: U.S. investment exists largely in manufacturing and service sectors where organized labor is predominant and working conditions are well above the average for India. U.S. investors generally offer better than prevailing wages, benefits and work conditions. Intense government and press scrutiny of all foreign activities ensures that any violation of acceptable standards under the five worker-rights criteria mentioned above would receive immediate attention.

Extent of U.S. Investment in Selected Industries -- U.S. Direct Investment Position Abroad on an Historical Cost Basis **--** 1997

(Millions of U.S. Dollars)

Category		Amount
Petroleum		175
Total Manufacturing		380
Food & Kindred Products	32	
Chemicals & Allied Products	143	
Primary & Fabricated Metals	-54	
Industrial Machinery and Equipment	183	
Electric & Electronic Equipment	47	
Transportation Equipment	16	
Other Manufacturing	14	
Wholesale Trade		43
Banking		598
Finance/Insurance/Real Estate		206
Services		47
Other Industries		235
TOTAL ALL INDUSTRIES		1,684

Source: U.S. Department of Commerce, Bureau of Economic Analysis.